

Economic Outlook



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A few early reports indicate that the economy turned in a sluggish performance in October, but not sufficiently so as to raise serious concern about the possibility of an impending downturn. The most likely course of the economy still seems to us to be slow growth in the fourth quarter of this year and early next year, with a rebound appearing roughly by the spring. The reacceleration would be a response to recent declines in interest rates and the correction of the inventory overhang that has developed in a few sectors of the economy. Real GNP is expected to rise a moderate 3.3% from the fourth quarter of 1984 to the fourth quarter of 1985, following an estimated increase of 5.7% from the fourth quarter of last year to the fourth quarter of this year.

Some of the recent weakness in the economy reflects the auto strikes in the U.S. and Canada. For example, domestic auto sales fell to 6.9 million units at an annual rate in October, versus 7.9 million units in September. Sales are expected to move quickly back into the 8.0-8.5 million unit range as production returns to normal levels. The slowdown in the economy extends well beyond the strikes, however. The sluggishness in consumer spending has worked its way through the chain of production and has resulted in a series of declines (on a month-to-month basis) in manufacturers' new orders. As an illustration of the resulting inventory imbalance that has developed, the ratio of inventories to new orders of manufacturers of home goods and apparel rose sharply in September to the highest point since late 1982 (more because of the decline in orders than the rise in inventories). It will probably take until next spring before inventories move into comfortable alignment with orders and sales.

The weakness in manufacturers' new orders also partially reflects the strength of the dollar. Although the dollar has fallen from recent highs, the cumulative effect of the strong dollar is evident in the merchandise trade statistics. During the first nine months of 1984 exports were 8.5% higher than a year ago, while imports increased 31.6%. The trade deficit is expected to be a record \$130 billion this year and \$148 billion next year.

Warnings about the effects of "crowding out" have been raised for some time now, but the predictions have generally been off the mark. Ironically, though, some of the fears of the consequences of crowding out are now coming true, but through a rather circuitous route. The Federal Reserve has maintained a relatively restrictive monetary policy to offset the inflationary potential of the substantial fiscal stimulus provided by large Federal government deficits. The resulting high real interest rates have in turn been a major force in keeping the dollar strong, and the strong dollar has made it difficult for many U.S. firms to compete both at home and abroad. Thus, America's industrial base has felt the consequences of crowding out, but primarily through the effects of exchange rates rather than directly through interest rates. The extent to which President Reagan can succeed in reducing the budget deficit, while at least in principle adhering to the broad program of economic initiatives begun in his first term, will be a pivotal factor in determining the course of the economy during his second term.

Bernard Schoenfeld



Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
	1984				1985				1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	14.9	10.7	6.3	7.1	7.2	8.8	9.4	8.2	7.7	10.9	7.9
Real GNP	10.1	7.1	2.7	2.9	2.5	4.3	4.1	2.6	3.7	6.9	3.4
GNP Price Deflator	4.4	3.3	3.6	4.0	4.5	4.4	5.1	5.5	3.8	3.8	4.3

	Actual	Forecast	Actual	Forecast
	1984: III	1984: IV	1982-1983	1983-1984 1984-1985
Consumer Spending	4.6%	7.8%	8.6%	8.7% 7.6%
Durable Goods	-4.2	-1.0	14.2	13.1 5.7
Nondurable Goods	2.4	8.4	5.8	7.4 6.5
Services	9.0	9.8	9.4	8.5 9.0
Business Capital Spending	10.6	13.3	0.9	20.2 14.2
Structures	4.3	12.0	-8.7	15.6 13.2
Equipment	14.3	14.0	7.6	22.8 14.8
Residential Investment	2.6	3.0	44.6	17.5 5.3

	1983	1984	1985
Change in Inventories	\$72.4b.	\$54.0b.	\$-13.5b.
Net Exports of Goods and Services	\$-85.5b.	\$-81.0b.	\$-8.3b.

	1982-1983	1983-1984	1984-1985
Government Purchases	13.1%	9.8%	5.4%
Federal	16.2	11.0	4.2
Defense	8.7	12.8	11.7
Other	40.4	6.0	-12.7
State & Local	11.0	9.0	6.2

Corporate Profits Before Tax	6.9*F	10.0*	22.8	20.6	8.1
Corporate Profits After Tax	4.1*F	7.4*	21.6	17.9	7.8
Plant and Equipment Expenditures	20.0F	17.0	-4.8	15.3	14.2
Real Final Sales*	0.0	4.8	3.2	4.9	3.9
Real Disposable Personal Income	3.5	3.9	3.5	6.7	3.8

Economic Indicators	Recent Data			Actual	Forecast	
	July	Aug.	Sept.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	3.6%	6.0%	4.8%	3.8%	4.6%	5.0%
Producer Price Index for Finished Goods**	3.6	-1.2	-2.4	0.6	2.5	5.0
Industrial Production	10.9	1.4	-7.2	6.5	10.8	4.6
Retail Sales**	-1.7	-0.6	1.6	9.3	10.2	7.8
Auto Sales	10.6	10.0	10.3	9.2	10.5	10.6
(millions of units, a.r.)						
Housing Starts	1.75	1.54	1.68	1.70	1.80	1.67
(millions of units, a.r.)						
Unemployment Rate	7.5	7.5	7.4	9.6	7.6	6.9
Merchandise Trade Deficit (a.r.)	\$168.7b.	\$118.3b.	\$151.8b.	\$69.4b.	\$130.0b.	\$148.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

*GNP less change in inventories, both in real terms.

**Monthly percent changes are not annualized.

*Year-over-year percent changes.

**Annual percent changes are December to December (not seasonally adjusted).

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\$b. = billions a.r. = annual rate F = Forecast